

5/15/12

**REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL  
LEGISLATURE AND THE COUNCIL ON KGATELOPELE LOCAL MUNICIPALITY**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the financial statements of the Kgatelopele Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets, the statement of comparison of budget and actual amounts and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

**Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 05 of 2012) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor-General's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis for disclaimer of opinion**

**Property, plant and equipment**

4. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment, as the municipality did not provide sufficient supporting documentation to confirm the balance of property, plant and equipment. Furthermore I could not physically verify the assets due to a lack of information on the asset register. The asset register of the municipality did not contain sufficient and appropriate information, such as a unique identification number, to permit the identification of each individual asset or its specific location. I was unable to confirm the property, plant and equipment by alternative means. Consequently I was unable to determine whether any adjustment relating to property, plant and equipment stated at R72 301 671 (2012: R76 675 034) in the financial statements was necessary. Additionally we cannot determine the impact on depreciation and impairment loss.

**Revenue from exchange transactions**

5. I was unable to obtain sufficient appropriate audit evidence for service charges and journal transactions. Municipality has an inadequate system of internal control to account for revenue and poor record keeping for all revenue charged. I was unable to confirm service charges by alternative means. Consequently, I was unable to determine whether any adjustments relating to service charges stated at R24 674 345 (2012: R22 354 204) in the financial statements was necessary.

**Irregular expenditure**

6. The municipality made payments in contravention of supply chain management requirements which were not included as irregular expenditure, resulting in irregular expenditure being understated by R22 576 745(2012: R6 261 779). In addition, I was unable to obtain sufficient appropriate audit evidence as the municipality could not provide all the required supporting documentation and evidence that management has properly identified, investigated and recorded all irregular expenditure. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments relating to irregular expenditure in the financial statements were necessary.

**Receivables from exchange transactions**

7. The municipality did not measure consumer debtors at amortised cost in accordance with GRAP 104, *Financial instruments: Recognition and measurement* and did not differentiate between long term and short term receivables in accordance with GRAP 1. The municipality did not comply with these requirements. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to consumer debtors stated at R6 649 129 (2012: R6 550 189) in note 6 to the financial statements was necessary.

**Payables from exchange transactions**

8. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions, as municipality has inadequate filing management and system of internal control to account for payables from exchange transactions. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to payables from exchange transaction stated at R3 304 750 (2012: R2 399 039) in the financial statements was necessary.

**Cash and cash equivalent**

9. The municipality did not recognise cash and cash equivalent in accordance with Standard of Generally Recognised Accounting Practice, GRAP 2, *Cash Flow Statements*. The municipality did not perform adequate bank reconciliation at year-end. Consequently, cash and cash equivalent is overstated by R2 015 207.

**Value-added tax**

10. I was unable to obtain sufficient appropriate audit evidence for taxes as the municipality could not provide supporting documentation for the difference between the balance as per the VAT reconciliation re-performed and the VAT balance as disclosed in the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the tax receivable stated at R2 355 739 (2012: R1 286 748) in the financial statements was necessary.

**Provisions**

11. The municipality did not have adequate systems in place to maintain records of provisions as leave pay accrual and bonuses were incorrectly classified as provisions, which resulted in provisions being overstated by R1 411 047. I was unable to obtain sufficient appropriate audit evidence for provisions as the municipality could not provide appropriate audit evidence supporting the reasonableness of the valuation assumptions. Furthermore, I was unable to confirm the provision by alternative means. Consequently I was unable to determine whether any adjustments relating to provisions stated at R1 930 953 (2012: R1 929 774) in the financial statements was necessary.

**Investment property**

12. The municipality did not recognise all property held to earn rentals or for capital appreciation as investment property for current and prior year in accordance with Standard of Generally Recognised Accounting Practice, GRAP 16, *Investment property*. Additions to investment property were incorrectly recognised as property, plant and equipment. Consequently, investment property is understated by R1 405 115 and property plant and equipment is overstated by R1 405 115. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.

**Contingent liabilities**

13. The municipality did not disclose contingent liabilities in accordance with GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets*. The municipality has various lawsuits pending for current and prior year that were not disclosed. Consequently, contingent liabilities were understated by R790 578 (2012: 790 578).

**Consumer deposits**

14. I was unable to obtain sufficient appropriate audit evidence to confirm the balance of consumer deposits due to the lack of evidence that management has properly charged and accounted for all consumer deposits at the correct amount. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to consumer deposits stated at R430 663 (2012: R272 075) in the financial statements was necessary.

**Cash flow statement**

15. I was unable to obtain sufficient appropriate audit evidence regarding the cash flow statement, due to the limitations placed on my audit of various components of the financial statements. I was unable to confirm the cash flow statement by alternative means. Consequently, I was unable to determine whether any adjustment relating to the cash flow statement in the financial statements was necessary.

**Inventory**

16. The municipality did not recognise all current assets held for sale and current assets for consumption or distribution during the ordinary course of business for current and prior year in accordance with Standard of Generally Recognised Accounting Practice, GRAP 12, *Inventories*. Consequently, inventory is understated. I was not able to determine the full extent of the understatement in inventories as it was impracticable to do so. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.

**Employee benefits**

17. The municipality did not recognise all employee post employment benefits meeting the definition of employee benefit for current and prior year in accordance with Standard of Generally Recognised Accounting Practice, GRAP 25, *Employee benefit*. Consequently, post employment benefits are understated. I was unable to determine the full extent of the understatement in post employment benefits as it was impracticable to do so. Additionally, there is a consequential impact on the surplus for the period and the accumulated.

**Commitment**

18. I was unable to obtain sufficient appropriate audit evidence for commitment as municipality did not have adequate systems and complete contract register to detect and record all commitments in the disclosure note. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments relating to commitment in the financial statements were necessary.

**Material losses**

19. I was unable to obtain sufficient appropriate audit evidence regarding distribution losses. I was unable to confirm the full extent of distribution losses by alternative means. Consequently, I was unable to determine whether any adjustments relating to distribution losses in the financial statements were necessary.

**Related Parties**

20. The municipality did not disclose the aggregate remuneration of key management personnel and number of individuals, determined on a full time equivalent basis, receiving remuneration within this category, showing separately major classes of key management personnel and including a description of each class in accordance with IPSAS 20, *Related Parties*. The remuneration of key management personnel is not detailed for each individual key management personnel.

**Unauthorised Expenditure**

21. During 2012 I was unable to obtain sufficient appropriate audit evidence about unauthorised expenditure. I was unable to confirm the unauthorised expenditure by alternative means. Consequently I was unable to determine whether any adjustment relating to unauthorised expenditure stated at R8 017 144 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

**Financial instruments**

22. The municipality did not disclose information on liquidity risks, maturity analysis, and sensitivity analysis and credit risk exposure in accordance with GRAP 104, *financial instruments*. Contrary to the minimum disclosure requirements, the municipality's exposure to financial risks and how these risks were mitigated were not disclosed in the financial statements. Furthermore, the municipality did not disclose gains or losses on financial instruments, trade receivables overdue but not impaired, as well as the factors that the municipality considered in determining impairment. I was not able to determine the full extent of the misstatement of financial instrument disclosed in note 35 to the financial statements as it was impracticable to do so.

**Service in kind**

23. The municipality did not have adequate systems in place to maintain records of service in kind, for example a secondment of the finance advisor from National Treasury was utilised during the year but was not disclosed in the financial statements.

**Aggregation of immaterial uncorrected misstatements**

24. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position and the statement of financial performance:
- Expenditure reflected as R57 138 798 is overstated by R106 415.
  - Intangible assets reflected as R67 050 is understated by R136 584.
25. In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm the following elements by alternative means:
- General expenses of R342 279 as included in a balance of R7 077 897.
  - Prepayments of R303 049 as included in the disclosed balance of R368 159.
26. As a result, I was unable to determine whether any adjustments to the above mentioned

elements were necessary.

#### **Disclaimer of opinion.**

27. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

#### **Emphasis of matters**

28. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Restatement of corresponding figures**

29. As disclosed in note 33 and 34 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during 30 June 2013 in the financial statements of the municipality at, and for the year ended, 30 June 2012.

#### **Material under spending of conditional grants**

32. As disclosed in the note 8 to the financial statement, the municipality has materially under spent the conditional grants to the amount of R9 536 080 (72%). This under spending was due to unrest experienced by the municipality resulted in resignation of the municipal manager and the chief financial officer. Municipal offices and vehicles were destroyed as such, as a consequence, the municipality could not achieve its objective and therefore under spent.

#### **Additional matter**

33. I draw attention to the matter below. My opinion is not modified in respect of these matters.

#### **Material inconsistencies in other information included in the annual report**

34. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

#### **Predetermined objectives**

30. The annual performance report was not presented for audit and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.
31. The information was assessed to determine whether performance indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*

#### **Usefulness of information**

- 35 The *National Treasury Framework for managing programme performance information* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the National Treasury Framework for managing programme performance information but did not receive the necessary training to enable application of the principles.
- 36 The *National Treasury Framework for managing programme performance information* requires that performance targets be measurable. The required performance could not be measured for a total of 100% of the targets. This was due to the fact that management was aware of the requirements of the National Treasury Framework for managing programme performance information but did not receive the necessary training to enable application of the principles.
- 37 The *National Treasury Framework for managing programme performance information* requires that the time period or deadline for delivery be specified. A total of 100% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the National Treasury Framework for managing programme performance information but did not receive the necessary training to enable application of the principle.
- 38 The *National Treasury Framework for managing programme performance information* requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the National Treasury Framework for managing programme performance information but did not receive the necessary training to enable application of the principles.
- 39 The *National Treasury Framework for managing programme performance information* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to lack of key controls in the relevant systems of verification of actual performance information.

#### **Compliance with laws and regulations**

- 40 I performed procedures to obtain evidence that the municipality has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

#### **Strategic planning and performance management**

- 41 The municipality did not establish a performance management system that is in line with the priorities, objectives, indicators and targets contained in its integrated development plan, did not clarify the roles and responsibilities of each role player in the functioning of the system, did not determine the frequency of reporting and the lines of accountability for performance, did not relate to the municipality's performance management processes and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38(a) of the Municipal system Act and Municipal Planning and Performance Management Regulations 7(2)(c), (e), (f) and (g).

- 42 The municipal council did not review its integrated development plan annually in accordance with an assessment of its performance measurements in terms of section 41 and to the extent that changing circumstances demanded, as required by section 34 of the Municipal Systems Act and Municipal Planning and Performance Management Regulations 3.
- 43 The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act.

#### **Budgets**

- 44 Monthly budget statements were not submitted to the Mayor and relevant provincial treasury, as required by section 71(1) of the Municipal Finance Management Act.

#### **Annual financial statements, performance and annual reports**

- 45 The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure, disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were provided subsequently, but the uncorrected material misstatements and/or supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.

#### **Audit committees**

- 46 An audit committee was not in place, as required by section 166(1) of the Municipal Finance Management Act.

#### **Internal audit**

- 47 An internal audit unit was not established, as required by section 165(1) of the Municipal Finance Management Act.

#### **Procurement and contract management**

- 48 Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by Municipal Supply Chain Management regulation 17(a) & (c).
- 49 Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by Municipal Supply Chain Management regulation 19 (a).
- 50 Quotations accepted were from prospective providers who are registered on the list of accredited prospective providers and do meet the listing requirements prescribed by the Municipal Supply Chain Management policy in contravention of Municipal Supply Chain Management regulation 16(b) and 17(b).
- 51 Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by Municipal Supply Chain Management regulation 27(2)(a).
- 52 Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with Supply Chain Management regulation 29(2)
- 53 The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and Municipal Supply Chain Management regulation 28(1)(a)

- 54 Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of the Preferential Procurement Policy Framework Act.
- 55 The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the Municipal Finance Management Act.
- 56 Contract and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by Municipal Supply Chain Management regulation 13(c).
- 57 Awards were made to providers who are persons in service of other state institutions or whose directors or principal shareholders are persons in service of other state institutions, in contravention of Municipal Supply Chain Management regulations 44.
- 58 Sufficient appropriate audit evidence could not be obtained that the prospective providers list for procuring goods and services through quotations were updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were invited to apply for such listing at least once a year as per the requirements of Municipal Supply Chain Management regulation 14(1)(a)(ii) and 14(2).
- 59 Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as management could not provide the supporting documentation.

#### **Human resource management and compensation**

- 60 An approved staff establishment was not in place, as required by section 66(1)(a) of the Municipal Systems Act.
- 61 The municipal manager has not established a process or mechanism to regularly evaluate the staff establishment as required by section 66(1)(d) of the Municipal Systems Act.
- 62 The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the Municipal Systems Act.
- 63 The competencies of financial officials and supply chain management officials were not assessed promptly in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels reg 13.
- 64 The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Regulations on Minimum Competency Levels reg14(2)(a).
- 65 The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Regulations on Minimum Competency Levels reg14(2)(b).

#### **Expenditure management**

- 66 Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the Municipal Finance Management Act.
- 67 Reasonable steps were not taken to prevent unauthorised expenditure / irregular expenditure / fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act.
- 68 An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred or accounted for creditors or accounted



for payments made, as required by section 65(2)(b) of the Municipal Finance Management Act.

#### **Conditional grants**

- 69 Unspent conditional grant funds was not approved by the National Treasury for retention, were not surrendered to National Revenue Fund, as required by section 20(1) of the Division of Revenue Act.
- 70 The municipality did not submit quarterly performance reports to the transferring national officer, and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the Division of Revenue Act.

#### **Revenue management**

- 71 An adequate management, accounting and information system was not in place which recognised revenue when it was earned and accounted for debtors, as required by section 64(2)(e) of the Municipal Finance Management Act.
- 72 Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality was calculated on a monthly basis, as required by sections 64(2)(b) and 97(e) of the Municipal Finance Management Act.

#### **Asset management and liability management**

- 73 An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.
- 74 An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.

#### **Consequence management**

- 32. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the Municipal Finance Management Act.
- 33. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the Municipal Finance Management Act.
- 34. Irregular and fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the Municipal Finance Management Act.

#### **Internal Control**

- 35. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

- 75 Management did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.

- 76 Management did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.
- 77 Management did not establish and communicate approved policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities.
- 78 Management did not develop and monitor the implementation of action plans to address internal control deficiencies.
- 79 Management did not establish an information technology governance framework that supported and enabled the business, delivered value and improved performance.

#### **Financial and performance management**

- 80 Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
- 81 Management did not implement controls over daily and monthly processing and reconciling of transactions.
- 82 Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
- 83 Management did not review and monitor compliance with applicable laws and regulations.
- 84 Management did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information

#### **Governance**

- 85 Appropriate risk management activity was not implemented to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks are developed and monitored
- 86 The accounting officer did not prioritise the establishment of a fully functioning internal audit unit and audit committee, therefore the functions were not established and functional during the financial year.

*Auditor - General*

Kimberley

30 November 2013



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*